85-554

No.

Supreme Court, U.S.
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CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

HUGHES PROPERTIES, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTION PRESENTED

Whether a gambling casino using the accrual method of tax accounting may deduct amounts shown on the "jackpot indicators" of its progressive slot machines at the close of its taxable year, even though it has no obligation to pay those amounts unless and until the jackpots are won by its patrons in some future year.

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UNITED STATES OF AMERICA, PETITIONER

v.

HUGHES PROPERTIES, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-3a) is reported at 760 F.2d 1292. The opinion of the Claims Court (App., *infra*, 5a-20a) is reported at 5 Cl. Ct. 641.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 4a) was entered on May 2, 1985. On July 11, 1985, the Chief Justice extended the time within which to petition for a writ of certiorari to and in-

cluding September 29, 1985 (a Sunday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 162, 446 and 461 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Section 1.461 of the Treasury Regulations on Income Tax (26 C.F.R.), are set out in a statutory appendix (App., *infra*, 22a-24a).

STATEMENT

1. The relevant facts were stipulated (App., *infra*, 5a). Respondent Hughes Properties, Inc., is a Nevada corporation that owns Harolds Club, a gambling casino in Reno, Nevada (*id.* at 6a). During the tax years at issue, respondent operated "progressive slot machines" in its casino (*ibid.*). Like other slot machines, a "progressive" slot machine pays fixed amounts when certain combinations of apples, oranges or other symbols appear. Unlike other slot machines, however, a "progressive" machine also has an additional, "progressive" jackpot. This jackpot is initially set at a minimum amount determined by the casino (*id.* at 6a; C.A. App. 45-46). It automatically increases, according to a ratio determined by the casino, as money is gambled on the machine. The amount of the jackpot outstanding at any given time is registered on a meter, or "payoff indicator," on the face of the machine (App., *infra*, 6a-7a & n.2). This sum continues to increase as patrons gamble on the machine until the jackpot is won or until a maximum amount, again determined by the casino, is reached (*id.* at 6a). A progressive jackpot can be won only when a customer gambles the required amount of

money and the machine displays the winning combination of symbols (*ibid.*).

The odds of winning a progressive jackpot are a function of the number of reels on the machine, the number of positions on each reel where the reel may stop, and the number of winning symbols placed on each reel (App., *infra*, 6a; C.A. App. 46). The odds are determined by respondent; provided that there actually exists a possibility that the winning combination of symbols can appear, respondent's discretion in setting odds is unrestricted. By adjusting the odds, respondent can determine, within limitations prescribed by the law of averages, the frequency with which any particular progressive slot machine will pay off. In a 1976 study of 24 representative machines, respondent ascertained that one machine had been in operation for 13 months without a payoff, that another machine had been in operation for 35 months without a payoff, and that the payoff frequency of the other 22 machines ranged from a high of 14.3 months to a low of 1.9 months (App., *infra*, 7a n.1).

2. In September 1972 the Nevada Gaming Commission promulgated a rule that, for the first time, regulated the use of progressive slot machines by licensed casinos. Nev. Gaming Reg. § 5.110 (reprinted in App., *infra*, 7a-9a nn. 2 & 3). The rule requires gaming establishments to maintain daily records of the progressive jackpot amounts registered on each machine (Nev. Gaming Reg. § 5.110(5)). It directs that "[n]o payoff indicator shall be turned back to a lesser amount" unless the progressive jackpot is won by a customer, or unless "the change in

the indicator reading is necessitated through a machine malfunction" (*id.* § 5.110(2)). In the latter event, a report explaining the reduction in the payoff indicator must be filed (*id.* § 5.110(5)). This rule is strictly enforced by the Gaming Commission, which is authorized to impose sanctions (including license revocation) on casinos that wrongfully refuse to pay a progressive jackpot to a winning customer or that otherwise breach the Commission's rules (App., *infra*, 9a).

The Gaming Commission rule described above applies to all Nevada casinos so long as they remain in the gaming business (C.A. App. 59). If a casino were to go out of business, to surrender its gaming license, or to enter bankruptcy proceedings, it would no longer be subject to the rule and would be free to reduce or eliminate the amounts shown on its progressive jackpot indicators (*id.* at 58-59). The rule does not address the treatment of progressive slot machines in the event of the sale or other disposition of a gaming business. During the tax years in question, the Gaming Commission's unwritten policy in such circumstances was apparently to require the buyer to continue the progressive slot machines in play, without reduction of the payoff indicators (*id.* at 58). Whether the sales price would be adjusted to reflect that requirement, however, was a matter of negotiation between the buyer and the seller (*ibid.*).

3. Respondent uses the accrual method of accounting for federal tax purposes. In compliance with the Gaming Commission rule described above, respondent recorded the meter readings shown on its progressive slot machines every day and made no impermissible reductions of the machines' payoff indicators (App., *infra*, 9a). At midnight on the last day of its fiscal tax year, respondent entered the unpaid jackpot

amounts shown on those indicators as an "accrued liability" on its books (*ibid.*). From that total, respondent subtracted the previous year's accrued jackpot liability to produce a "net accrued liability" for the tax year in question (*id.* at 10a). On its federal income tax returns for 1973-1977, respondent deducted the latter amounts under Section 162 of the Code[1] as "ordinary and necessary [business] expenses paid or incurred during the taxable year."

On audit, the Commissioner disallowed the claimed deductions. Under the accrual method of tax accounting, he noted, an expense may not be deducted until "all of the events have * * * occurred which fix the liability" (Treas. Reg. § 1.461-1(a)(2)). The Commissioner determined that the events which would fix respondent's liability to pay a progressive jackpot would be some lucky patron's pull of the handle, and the consequent appearance of the winning symbols on the slot machine, in some future tax year. Until those events occurred, the Commissioner concluded, respondent's obligation to pay the jackpots was contingent and thus gave rise to no deductible expense (App., *infra*, 10a). The Commissioner accordingly determined a deficiency in respondent's income tax in the amount of $433,000 for the tax years at issue (*id.* at 1a, 21a).

4. Respondent paid the asserted deficiency and, following the denial of its administrative claim for refund, filed this refund suit in the Claims Court. That court ruled for respondent. It concluded that, under the Nevada Gaming Commission rule described above, respondent's liability to pay the amounts

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended and as in effect for the tax years at issue (the Code or I.R.C.).

shown on the progressive jackpot indicators became "unconditionally fixed" (App., *infra*, 14a) on "midnight of the last day of the fiscal year" (*id.* at 19a). In the Claims Court's view, the last event necessary to fix respondent's liability for the progressive jackpots was "the last play (successful or not) of the machine before the close of the fiscal year, that is, the last change in the jackpot amount before the amount is recorded for accounting purposes" (*id.* at 13a). "The winning handle pull," the court said, would "only determine[] the fortunate gambler in whose favor the liability [would be] enforced" (*id.* at 14a) (original quotation marks omitted)). The court seemed to acknowledge that if respondent "were to close its doors and go out of business, * * * it would not owe the jackpots to anybody" (*id.* at 15a (original quotation marks omitted)). But "[e]ven if the progressive slot machines were to never pay off," the court reasoned, "the set jackpot amounts indicated on the face of the machine[s] would still continue to be an *incurred* liability fixed by state law" (*id.* at 14a (emphasis in original)). The court "respectfully declined to follow" (*id.* at 15a) the Ninth Circuit's contrary decision in *Nightingale* v. *United States*, 684 F.2d 611 (1982).

The Federal Circuit affirmed (App., *infra*, 1a-3a). It acknowledged (*id.* at 2a) that the Claims Court had "declined to follow the contrary conclusion of the Ninth Circuit" in *Nightingale* v. *United States*, *supra*. However, without further discussing that decision or the reasoning that the Ninth Circuit there advanced, the court of appeals "affirm[ed] on the basis of the * * * Claims Court opinion," concluding that the trial judge had "carefully examined all of the arguments raised on the present appeal" (App., *infra*, 3a).

REASONS FOR GRANTING THE PETITION

The court of appeals has decided an important question of federal tax law in a way that conflicts directly with a recent decision of the Ninth Circuit. The reasoning of the opinion below is squarely at odds with fundamental principles enunciated by this Court to govern accrual of deductions under the "all events" test of tax accounting. The decision below produces an irrational result, for it permits respondent to take current tax deductions for amounts to which no one can assert any present claim and which respondent may never have to pay at all. The revenue impact of the decision below, rendered by a court of nationwide jurisdiction, would be substantial even if confined to the casino industry. But it is by no means clear that its effect would be so limited. The "all events" test is one of the most frequently-recurring concepts in tax law, and the Federal Circuit's erroneous construction of that test could be pressed into service by taxpayers seeking to take current deductions for almost any sort of contingent future liability. Review by this Court is therefore appropriate.

1. The decision below, as the Federal Circuit acknowledged (App., *infra*, 2a), squarely conflicts with the Ninth Circuit's decision, on virtually identical facts, in *Nightingale* v. *United States*, 684 F.2d 611 (1982). Like respondent, the taxpayer there was a Nevada gambling casino that used the accrual method of tax accounting (684 F.2d at 612). Like respondent, it sought to deduct unpaid amounts shown on the jackpot indicators of its progressive slot machines as "accrued liabilities" at the close of its tax year (*ibid.*). Like respondent, it was subject to the Nevada Gaming Commission rule prohibiting casinos

from turning back the payoff indicators on their slot machines (*id.* at 612-613). And like respondent, it contended that the year-end amounts shown on those indicators in consequence were "fixed liabilities" justifying deduction under the "all events" test of tax accounting, despite the fact that the jackpots had not yet been won by any player (*id.* at 613) .

The Ninth Circuit unanimously rejected the casino's argument. Notwithstanding the Gaming Commission rule, the court held, "[i]t [was] not true * * * that 'all events ha[d] occurred which determine[d] the fact of the liability' " at the close of the casino's tax year (684 F.2d at 614, quoting Treas. Reg. § 1.461-1(a)(2)). Rather, as the Ninth Circuit saw it (684 F.2d at 614):

> The one, indispensable such event is the winning of the progressive jackpot by some fortunate gambler. Until that event occurs, no actual liability has been incurred. Gambling being what it is, and gambling odds being what they are, it is entirely possible that no actual liability will ever occur. And if we assume that it is bound to occur some day, there is no way of knowing when that will be. The record shows that it may be four years hence.

If the casino "were to close its doors and go out of business," the court observed, "it would not owe the jackpots to anybody," a fact that "tend[ed] to show that there [was] no present liability" (684 F.2d at 615). Because the casino's liability on each slot machine was "contingent upon a winning pull," an event that "is most naturally regarded as a condition precedent" to the creation of a fixed obligation, the Ninth Circuit refused to permit deduction of progressive

slot machine jackpots before they are actually won by a customer (*id.* at 614-615).

2. In declining to follow the Ninth Circuit's reasoning, the Federal Circuit ignored basic principles of tax accounting enunciated long ago by this Court and subsequently embodied in the Treasury Regulations. The Code generally permits taxpayers to compute taxable income under either the "cash receipts and disbursements method" or the "accrual method" of tax accounting (I.R.C. § 446(c)(1) and (2)). Cash-method taxpayers may deduct expenses only in the year paid (Treas. Reg. §§ 1.446-1(c)(1)(i), 1.461-1(a)(1)). Accrual-method taxpayers, by contrast, are entitled to deduct expenses in the year "incurred," even though actual payment is deferred until a subsequent year. *E.g.*, I.R.C. § 162(a); see Treas. Reg. §§ 1.446-1(c)(1)(ii), 1.461-1(a)(2). It is well settled that " 'to incur' means to become liable or subject to.' " *Ox Fibre Brush Co.* v. *Blair*, 32 F.2d 42, 47 (4th Cir. 1929), aff'd *sub nom. Lucas* v. *Ox Fibre Brush Co.*, 281 U.S. 115 (1930). "[A] thing for which there exists no obligation to pay, either express or implied, cannot in law be claimed to constitute an 'expense incurred.' " *United States* v. *St. Paul Mercury Indemnity Co.*, 238 F.2d 594, 598 (8th Cir. 1956).

For more than fifty years, the standard for determining when an item of expense is to be regarded as "incurred," and hence as being properly deductible for federal tax purposes, has been the "all events" test. First articulated by this Court in *United States* v. *Anderson*, 269 U.S. 422, 424 (1926), the test was subsequently incorporated in the Treasury Regulations. It has two elements, both of which must be satisfied before accrual of an expense is proper.

First, "all the events [must] have occurred which establish the fact of the liability giving rise to [the] deduction" (Treas. Reg. § 1.446-1(c)(1)(ii)). Second, the amount of the deduction must be "determin[able] with reasonable accuracy" (*ibid.*). While the second part of the test permits a degree of computational flexibility, the Regulations emphasize that the first part of the test is absolute: "no accrual shall be made in any case [unless] all of the events have * * * occurred which fix the liability" (Treas. Reg. § 1.461-1(a)(2)).

In determining whether a liability has become "fixed," and thus constitutes an "expense incurred during the taxable year" for federal tax purposes, this Court early made clear that "a liability does not accrue as long as it remains contingent." *Brown* v. *Helvering*, 291 U.S. 193, 200 (1934). "The prudent businessman," Justice Brandeis wrote for the Court, "often sets up reserves to cover contingent liabilities. But they are not allowable as deductions." *Lucas* v. *American Code Co.*, 280 U.S. 445, 452 (1930) (footnote omitted). To be deductible for tax purposes, the liability must be "unconditional." *Lucas* v. *North Texas Lumber Co.*, 281 U.S. 11, 13 (1930). It must be "fixed and absolute." *Brown* v. *Helvering*, 291 U.S. at 201. "[T]he tax law requires," in short, "that a deduction be deferred until all the events have occurred that will make it fixed and certain." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 543 (1979) (original quotation marks omitted).

Respondent's liability for the progressive slot machine jackpots was plainly not "fixed and certain," was plainly not "unconditional" or "absolute," at midnight on the last day of its taxable year. At that moment, there existed no person at all who could assert any possible claim to those sums. If respondent

the following morning were to have closed its doors, sold its business, or entered bankruptcy, or if its patrons were to have ceased playing the slot machines, respondent would have had no liability, and would never have had any liability, to pay the jackpots to anyone—a fact that clearly demonstrates the conditional status of its obligation the night before. Respondent's obligation was in the nature of the offer of a prize, a prize that might be won if and when some future patron paid his money and plucked the winning combination of stars, bars, and fruit. So long as respondent chose to stay in the gambling business, of course, this offer was required to be irrevocable. But respondent's *liability* on the offer was nevertheless contingent. One does not have an "unconditional liability" unless there exists some person to whom he is liable, and respondent was not liable to anyone until somebody won the jackpot.

Contrary to the Federal Circuit's belief, the Nevada Gaming Commission rule concerning progressive slot machines does not alter the conditional nature of respondent's obligation. That rule simply sets a floor beneath the *amount* of respondent's liability, while leaving the liability itself contingent. The rule provides that the dollar amount of the jackpot respondent offers can never ratchet down, but must always stay the same or ratchet up; it dictates that respondent's liability, if and when it is incurred, will be in an amount proportional to the number of times the machine has previously been played. But the rule does not require respondent to pay a jackpot unless and until it is won by a customer. The rule thus leaves respondent's year-end liability in exactly the same contingent state that it was in before the Gaming Commission began regulating progressive slot machines in September 1972.

If respondent did have a fixed rather than a contingent liability at the close of its tax year, of course, the Gaming Commission rule could well permit the casino to satisfy the *second* prong of the "all events" test. Given the existence of that rule, arguably, "the amount [of respondent's year-end liability could] be determined with reasonable accuracy" (Treas. Reg. § 1.461-1(a)(2)). Respondent, however, did not have a fixed liability at that time, and the Gaming Commission rule makes no difference in determining whether this first, and essential, component of the "all events" test has been satisfied.

3. In permitting respondent to take a current deduction for a contingent future loss, the decision below also conflicts in fundamental principle with this Court's decisions emphasizing the critical differences between tax and financial accounting. As the Claims Court noted (App., *infra*, 11a), taxable income is generally computed "under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books" (I.R.C. § 446(a)). Section 446(b), however, sets forth an exception to this rule, providing that, if the accounting method used by the taxpayer "does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the [Commissioner], does clearly reflect income." The Regulations categorically state that "no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income." Treas. Reg. § 1.446-1(a)(2).

Section 446 and its implementing Regulations obviously "vest the Commissioner with wide discretion in determining whether a particular method of * * * accounting should be disallowed." *Thor Power Tool*

Co., 439 U.S. at 532. This Court early noted that the general rule permitting use of the taxpayer's usual accounting practice "is expressly limited to cases where the Commissioner believes that the accounts clearly reflect the net income." *Lucas* v. *American Code Co.*, 280 U.S. at 449. And the Court recently reaffirmed that the Commissioner in the accounting area has " '[m]uch latitude for discretion' " and that "his interpretation of the statute's clear-reflection standard 'should not be interfered with unless clearly unlawful.' " *Thor Power Tool Co.*, 439 U.S. at 532 (quoting *Lucas* v. *American Code Co.*, 280 U.S. at 449).

Congress's decision to grant the Commissioner "broad powers" (*Commissioner* v. *Hansen*, 360 U.S. 446, 467 (1959)) to depart from the taxpayer's accounting practice in computing taxable income owes to "the vastly different objectives that financial and tax accounting have." *Thor Power Tool Co.*, 439 U.S. at 542. "The primary goal of financial accounting is to provide useful information to management, shareholders, [and] creditors" and "to protect these parties from being misled" (*ibid.*). Financial accounting accordingly "has as its foundation the principle of conservatism, with its corollary that possible errors in measurement [should] be in the direction of understatement rather than overstatement of net income" (*ibid.*; original quotation marks omitted). "[T]he major responsibility of the Internal Revenue Service," by contrast, "is to protect the public fisc," so that "understatement of income is not destined to be its guiding light" (*ibid.*). Thus, whereas financial accounting "typically require[s] that a liability be accrued as soon as it can reasonably be estimated," the tax law mandates "that a deduction be deferred

until all the events have occurred that will make it fixed and certain" (*id.* at 543 (original quotation marks and footnote omitted)). "Indeed, th[is] Court's cases demonstrate that divergence between tax and financial accounting is especially common when a taxpayer seeks a current deduction for estimated future expenses or losses" (*id.* at 541 (citing cases)).

The court of appeals departed from these well-established principles in sustaining respondent's deduction. It may well be, as respondent's witnesses testified below, that the year-end accrual of its contingent slot machine liabilities "conform[ed] with generally accepted accounting principles" (C.A. App. 42). There was a probability, gambling being what it is, that respondent would eventually incur liability for its progressive slot machine jackpots. Although the timing of that liability's incurrence was largely within respondent's control, subject as it was to respondent's discretion in setting odds, there was also a mathematical possibility that the liability might be incurred the very next day. Thus, "the principle of conservatism" (*Thor Power Tool Co.*, 439 U.S. at 542) may well have required respondent to set up a reserve for those items at once and show them as a liability on its books. "[B]ut the accountant's conservatism cannot bind the Commissioner in his efforts to collect taxes" (*id.* at 543). Although "estimates, probabilities, and reasonable certainties * * * may be useful, even essential, in giving shareholders and creditors an accurate picture of a firm's overall financial health," the tax law, "with its mandate to preserve the revenue, can give no quarter to uncertainty" (*ibid.*). "Only a few reserves voluntarily established as a matter of conservative accounting are authorized

by the Revenue Acts." *Brown* v. *Helvering*, 291 U.S. at 201-202 (Brandeis, J.) (quoted in *Thor Power Tool Co.*, 439 U.S. at 543-544). A reserve for contingent slot machine liabilities is not among those so authorized.

In sustaining respondent's deduction, finally, the court of appeals ignored this Court's warning about the "potential for tax avoidance" (*Thor Power Tool Co.*, 439 U.S. at 538) inherent in accounting techniques of the sort involved here. As the Ninth Circuit observed in *Nightingale*, casinos on respondent's theory could put new machines on the floor near the end of their tax year "with whatever initial jackpot they chose and with whatever odds they liked. Then they could take a current deduction for the full amount even though payment of the jackpots might not occur for many years" (684 F.2d at 615). "If management's election among [such] options were dispositive for tax purposes, a firm * * * could decide unilaterally—within limits dictated only by its accountants—the tax it wished to pay" for a particular tax year (*Thor Power Tool Co.*, 439 U.S. at 544). "Such unilateral decisions would not just make the Code inequitable; they would make it unenforceable" (*ibid.*).

4. The question presented in this case has substantial administrative importance. We are advised by the IRS that there are currently pending administratively within its Nevada District 36 cases, entailing potential tax liabilities of about $28 million, that present the same question as the instant case. Furthermore, if the decision below is not reversed, the IRS anticipates that a number of other Nevada gambling casinos, which previously agreed to tax deficiencies after the Ninth Circuit rendered its deci-

sion in *Nightingale*, will file claims for refund. The aggregate amount of such refund claims is expected to equal or exceed the $28 million at issue in the 36 cases now pending administratively.

The above figures, moreover, do not take into account the impact of the Federal Circuit's decision on the casino industry in New Jersey. The IRS advises that the aggregate progressive slot machine liabilities of the New Jersey casino industry from its inception in 1978 through 1984 approximate $25 million. The IRS estimates that some $11 million in taxes is potentially at stake by reason of premature progressive jackpot accruals by New Jersey casinos.

As these numbers show, the revenue involved is considerable within the casino industry alone. The Federal Circuit's decision, however, could have an even more significant impact in other tax contexts. Many of this Nation's businesses use the accrual method of tax accounting, and the "all events" test is one of the most frequently-recurring concepts in tax law. The Federal Circuit's open-ended construction of the "fixed liability" component of that test could be pressed into service by accrual-basis taxpayers seeking current deductions for a host of contingent future liabilities—liabilities as diverse as employers' obligations on workmen's compensation claims and coal companies' obligations to restore strip-mined land. The Claims Court is a court of nationwide jurisdiction—any taxpayer in the country can have his case heard there, with review in the Federal Circuit, simply by filing a refund suit. Accrual-basis taxpayers can thus be expected to make vigorous attempts to extend the Federal Circuit's reasoning well beyond slot machines and the gaming industry.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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SEPTEMBER 1985

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

Appeal No. 85-503

HUGHES PROPERTIES, INC., APPELLEE

v.

THE UNITED STATES, APPELLANT

Decided: May 2, 1985

Before BENNETT, SMITH, and BISSELL, *Circuit Judges.*

BENNETT, *Circuit Judge.*

Appellant challenges the judgment of the United States Claims Court which granted Hughes Properties, Inc., an accrual basis taxpayer, a refund of $433,441.88 in federal income taxes plus assessed interest for the fiscal years ending on June 30 in 1973, 1974, 1975, and 1977. *Hughes Properties, Inc.* v. *United States*, 5 Cl. Ct. 641 (1984). We affirm.

The relevant facts in this case are stipulated. On cross-motions for summary judgment, the United States Claims Court * held that taxpayer had satis-

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* Judge Robert M. M. Seto.

fied the "all events" test required by Treas. Reg. § 1.461-1(a)(2) (1984). The court reasoned that as a result of section 5.110 of the Nevada Gaming Commission regulations on the use of progressive slot machines maintained by licensed casinos, taxpayer's liability to pay the amounts shown on the jackpot indicators was unconditionally fixed as of the close of the taxable year, notwithstanding the fact that no payment would occur unless and until a customer playing the machine actually achieved the winning combination of symbols. In so holding, the court declined to follow the contrary conclusion of the Ninth Circuit in *Nightingale* v. *United States*, 684 F.2d 611 (9th Cir. 1982).

Under the accrual method of accounting, an expense is deductible for a tax year in which all of the events have occurred that determine the fact of liability and the amount thereof can be determined with reasonable accuracy. Treas. Reg. § 1.446-1(c)(1)(ii) (1984).

Here, liability of the taxpayer for the recorded amount of the guaranteed jackpot obligation was fixed and it satisfied the requirements for accrual of a deduction. Liability exists if there is an obligation to perform an act and the cost of performance can be measured in money. The commission regulation makes the guaranteed jackpot a fixed liability. This liability is not contingent upon the time of payment or the identity of the jackpot winner. The taxpayer's method of accounting accurately reflects the casino's income and expenses. If we were to require that the deduction of a jackpot liability be deferred until the year of actual payment, rather than the year in which the liability accrued, it would distort taxable income for the year of payment. Here, the accounting

method used by taxpayer results in allocation of the expense to the year in which the revenues were earned.

The Claims Court has carefully examined all of the arguments raised on the present appeal. We have reexamined those arguments, the briefs, statutes, regulations, and authorities, and conclude that the court was legally correct when it granted summary judgment to the taxpayer. We affirm on the basis of the United States Claims Court opinion.

Affirmed

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

No. 85-503
594-82T

HUGHES PROPERTIES, INC., PLAINTIFF-APPELLEE

v.

THE UNITED STATES, DEFENDANT-APPELLANT

JUDGMENT

ON APPEAL from the U.S. Claims Court

This CAUSE having been heard and considered, it is

ORDERED and ADJUDGED: Affirmed.

Dated May 2, 1985

Entered By Order
of the Court

/s/ George E. Hutchinson
GEORGE E. HUTCHINSON
Clerk

Issued as a Mandate: June 18, 1985

APPENDIX C

IN THE UNITED STATES CLAIMS COURT

No. 594-82T

HUGHES PROPERTIES, INC.

v.

THE UNITED STATES

[Filed: June 29, 1984]

ON CROSS-MOTIONS
FOR SUMMARY JUDGMENT

OPINION

SETO, Judge:

This case is before the court on cross-motions for summary judgment with all relevant facts stipulated. The single issue before the court is whether certain liabilities, assertedly giving rise to the claimed deductions, have been fixed for the purpose of calculating federal income tax. For the reasons set forth below, the court concludes that plaintiff's motion should be granted and defendant's motion should be denied.

FACTS

Plaintiff, Hughes Properties, Inc., is a Nevada corporation which owns Harolds Club, a gambling casino located in Reno, Nevada. During the fiscal years ending on June 30 in 1973, 1974, 1975 and 1977, plaintiff owned and operated progressive slot machines in this gambling casino. A "progressive slot machine," like other, nonprogressive, slot machines, pays fixed jackpot amounts when specific combinations of symbols appear. Unlike other slot machines, however, a progressive slot machine also has an additional, "guaranteed," jackpot. This latter jackpot amount is initially set at a given minimum. The machine automatically increases, by a pre-set ratio, the amount of this jackpot as money is gambled on the machine, and displays that amount on a meter on the face of the machine. The amount will increase until the jackpot is won or until a maximum amount (predetermined by the casino) is reached. A "guaranteed" jackpot can be won only when (1) the customer gambles the required (and, usually, the maximum) amount of money *and* (2) the machine displays the correct combination of symbols.

During the taxable years in issue, plaintiff operated various types of progressive slot machines. These machines differ as to the number and value of coins that can be gambled by a customer and the number and size of the reels contained within a machine. In addition, some machines have two "guaranteed" jackpots, which alternate in availability with each pull of the handle. Because of the differences in types of machines, the odds of winning a jackpot vary. According to plaintiff's brief and pretrial sub-

mission, the average period between payoffs is approximately 4.5 months.[1]

In September 1972, the Nevada Gaming Commission promulgated Regulation § 5.110,[2] which, for the

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[1] "This determination was made as of September 1, 1976, for the twenty-four 4-reel progressive slot machines then in operation. All but two of these machines were installed prior to 1974. With the exception of two machines, one of which had been in operation for thirteen months and the other for thirty-five months, *that did not pay off* prior to September 1, 1976, the payoff frequency ranged from a high of 14.3 months to a low of 1.9 months." Plaintiff's brief at 4 (emphasis supplied). *See also* Transcript of Oral Argument, February 16, 1984, at 36.

[2] This regulation reads as follows:

Progressive Slot Machines
(As adopted September 1972)

1. This paragraph shall apply to any slot machine with a payoff indicator which has a payoff that increases as the machine is played.

2. No payoff indicator shall be turned back to a lesser amount, unless the amount by which the indicator has been turned back is actually paid to a winning player, or unless the change in the indicator reading is necessitated through a machine malfunction, in which case an explanation must be entered on the daily report as required in subsection 5.

3. If the payoff indicator progresses without a payoff until the indicators return to zero, some means must be utilized to add another digit, unless a dollar limit has been posted on the machine clearly visible to the player, and which was posted before any payoff was registered on the indicator. When the limit has been reached it must be permitted to remain until won by a player.

4. Once a payoff amount appears on an indicator, the rate of progression may not be changed until there has been a winner, and the indicator is returned to zero.

5. Records shall be maintained which record the

first time, regulates the use of progressive slot machines maintained by licensed casinos. This regulation directs licensed gaming establishments to compile and maintain daily records indicating the "guaranteed" jackpot amounts registered on each machine. The regulation further states that the displayed jackpot amounts cannot be reduced unless the jackpot is either won by a customer, or the slot machine is taken off the casino floor for repairs. In the latter case, a report explaining the reasons for the removal must be filed. *See* Nevada Gaming Regulation § 5.110(2) (as adopted September 1972).[3]

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amount of the indicated payoff at least once per day. Supporting documents shall be maintained to explain any reduction in the payoff amount from the previous entry. Such records and documents shall be retained for a period of three years. . . .

[3] The regulation as set forth in note 2 *supra*, was amended on March 1, 1977. The amended regulation states in part that:

4. No payoff indicator shall be turned back to a lesser amount unless one of the following circumstances occur [*sic*]:

(a) The amount shown on the progressive meter is paid to a player as a jackpot; or

(b) It becomes necessary to adjust the progressive meter to prevent the jackpot indicator from displaying an amount greater than the limit imposed by the licensee pursuant to paragraph 2 of this regulation; or

(c) It becomes necessary to change the jackpot indicator because of machine malfunction, in which case an explanation must be entered on the daily report as required by . . . this regulation.

5. *Payoff required.* Once a payoff amount appears on a jackpot indicator, the progressive meter may not be decreased except as allowed by this regulation. A progressive jackpot may be transferred to another progressive machine at the same location in the event of machine malfunction, replacement, or for other good reason. When

Regulation § 5.110 is strictly enforced by the Nevada Gaming Commission (hereinafter "Commission"). *See* Affidavit of John H. Stratton, former member of Nevada Gaming Control Board, p. 2 at ¶ 4. The Commission is authorized by § 463.310 of the Nevada Revised Statutes to impose severe administrative sanctions (including license revocation) upon any casino that wrongfully refuses to pay a winning customer a "guaranteed" jackpot. Hence, once accumulated, a "guaranteed" jackpot cannot be lessened or eliminated except by a payoff.

In accordance with Regulation § 5.110(2), plaintiff recorded the meter readings on its progressive slot machines and did not decrease any of the progressive jackpot amounts except as allowed by the regulation. These meter readings provided the numerical data for the deductions taken by plaintiff and placed at issue here. The accrued but unpaid progressive slot machine jackpot amounts as reported by the plaintiff from 1973 to 1977 were:[4]

Fiscal Year Ended June 30	Accrued Liability	Expense (Income)
1973	$360,228.55	$360,228.55
1974	563,983.99	203,755.44
1975	853,584.22	289,600.23
1976	839,400.97	(14,183.25)
1977	888,820.67	49,419.70

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the maximum jackpot limit is reached, it must be permitted to remain until won by a player. (Emphasis supplied.)

The amendments to this regulation did not change the force or scope of this law [*sic*] and therefore do not affect this court's ruling.

[4] Plaintiff's brief at 6.

Plaintiff deducted as an ordinary and necessary business expense the *net* accrued liability for each fiscal year. The net accrued liability is determined by subtracting the previous year's accrued liability, which has already been deducted, from the current gross liability as indicated by the meter totals. For example, on midnight of the last day of fiscal year 1974, plaintiff's accountants totaled the figures appearing on the meters of the progressive slot machines and determined that their gross liability for that fiscal year was $563,983.99. Since plaintiff had already deducted $360,228.55 as a business expense in the previous fiscal year, the net accrued liability was $203,755.44. This is the amount that plaintiff reported as a deduction on its income tax returns for fiscal year 1974.

Although there is no dispute as to the *accuracy* of the amounts deducted by plaintiff,[5] the Internal Revenue Service ("IRS") denied plaintiff's deductions, claiming that the jackpot payoffs can only be deducted in the year actually paid because the jackpot amounts were merely a contingent liability. Defendant contends that these amounts are only deductible when actually won by a customer. Plaintiff sought a refund from the IRS after paying the assessed taxes and asserted that the accrued expense deductions were timely because the liability is fixed by Nevada state law. After plaintiff's request for a refund was denied, this suit was instituted.

DISCUSSION

Business expenses are deductible under the Internal Revenue Code, Title 26 of the United States Code (hereinafter "the Code" or "IRC"):

[5] Transcript of Oral Argument at 3-4.

> In general—there shall be allowed as a deduction all the *ordinary and necessary* expenses paid or incurred during the taxable year in carrying on any trade or business. . . . [IRC § 162(a) (Emphasis supplied).]

Defendant does not contest the deductibility *per se* of plaintiff's liability for the "guaranteed" jackpot amounts, but rather takes issue with the timing of those deductions. The timing of a deduction is determined with reference to IRC § 461(a), which states the general rule: "The amount of any deduction . . . shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income." Plaintiff computes its income by the accrual method of accounting, as allowed by subsections (a) and (c)(2) of § 446 of the Code. The pivotal question thus becomes whether plaintiff, in accruing the unpaid, "guaranteed" jackpots as liabilities, properly utilized the accrual method of accounting.

Treasury Regulation § 1.461-1(a)(2) explains the general rule for the timing of deductions by adopting a test first formulated by the Supreme Court in *United States v. Anderson*, 269 U.S. 422 (1926). This test, now known as the "all events" test, is stated as follows:

> [U]nder an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of liability and the amount thereof can be determined with reasonable accuracy.

The Court of Claims has accepted this test, restating it as follows:

> First, the taxpayer must show that the *fact of liability* is certain as of the end of the [fiscal] year in question. Second, the taxpayer must demonstrate that the amount of the liability can be reasonably ascertained. [*Eastman Kodak Company v. United States*, 209 Ct. Cl. 365, 375, 534 F.2d 252, 258 (1976) (Emphasis in original).]

When these two criteria are satisfied, the deduction must be allowed even though actual payment is deferred to a different fiscal year. *Clark v. Woodward Construction*, 179 F.2d 176 (10th Cir. 1950). *See also Dixie Pine Products Co. v. Commissioner*, 320 U.S. 516, 519 (1944). To deny a deduction that has satisfied the test would be contrary to the intent of the regulation as well as to the fundamental accounting principle that accrual accounts immediately reflect expenses incurred without regard to the timing of actual payment.

In this action, defendant's counsel, during oral argument, stated that the accuracy of the amounts deducted by plaintiff is not in issue.[6] Defendant asserts, however, that the first prong of the "all events" test has not been satisfied. It specifically rejects plaintiff's argument that the jackpot liability was fixed, despite admitting that plaintiff is precluded from avoiding payment as a result of Nevada Gaming Commission Regulation § 5.110. To support its theory, defendant cites *Nightingale v. United States*, 684 F.2d 611 (9th Cir. 1982), a case also involving a Nevada gambling casino seeking to deduct accrued progressive slot machine jackpot amounts based upon

[6] Transcript of Oral Argument at 3-4 ("There is no dispute in this case as to the reasonable accuracy of the amounts.")

the theory that the liability was fixed by state law. In *Nightingale*, the Ninth Circuit denied the deduction for accrued but unpaid jackpot expenses because it found that the "all events" test had not been satisfied. The court held that:

> The one indispensable . . . event is the winning of the progressive jackpot by some fortunate gambler. * * * Gambling being what it is, and gambling odds being what they are, it is entirely possible that no actual liability will ever occur. * * * [T]here is no way of knowing when any particular 'one armed bandit' will pay off, nor what the amount of that payoff will then be. [684 F.2d at 614.]

The *Nightingale* court reasoned that without the "one indispensable . . . event," the liability for accumulated but unpaid jackpot amounts was contingent and therefore did not satisfy the first prong of the "all events" test.

The essential argument, therefore, concerns the last event necessary to satisfy the "all events" test. Defendant contends that this last event is the actual, winning handle pull. Plaintiff contends that the last event is the last play (successful or not) of the machine before the close of the fiscal year, that is, the last change in the jackpot amount before the amount is recorded for accounting purposes. We believe that the latter view is correct. In *Clark*, *supra*, the court stated: "The decisive factor is the creation of an enforceable liability." 179 F.2d at 177. In *Trinity Construction Co. v. United States*, 424 F.2d 302, 305 (5th Cir. 1970), it was held that: "Accrual of a deduction is permitted only in the taxable year when the obligation to pay it is unconditionally

fixed" (*citing Brown v. Helvering*, 291 U.S. 193 (1934); *Security Flour Mills Co. v. Commissioner of Internal Revenue*, 321 U.S. 281 (1944); and *Whitaker's Estate v. Commissioner of Internal Revenue*, 259 F.2d 379 (5th Cir. 1958)). At the end of plaintiff's fiscal year, plaintiff's obligation to pay out the recorded amount is "unconditionally fixed" by the terms of § 5.110. Under that regulation, the liability for the jackpot amount can be enforced by the Nevada Gaming Commission. The winning handle pull, on the other hand, only determines the "fortunate gambler" in whose favor the liability is enforced. That the identity of that "fortunate gambler" is unknown, that the exact time the jackpot will be won is unknown, or that the exact amount of the jackpot at the time it is won is unknown does not affect the certainty of the liability at the end of plaintiff's fiscal year; in other words, "when the liability itself is clearly fixed . . . other uncertainties do not necessarily destroy that initial certainty." *Washington Post Co. v. United States*, 186 Ct. Cl. 528, 536 (1969). In the fact setting before the court, the uncertainties listed above do not destroy the "initial certainty" of liability. Even if the progressive slot machines were to never pay off, the set jackpot amounts indicated on the face of the machine[s] would still continue to be an *incurred* liability fixed by state law, for which plaintiff would continue to be responsible. Plaintiff's deductions for the net accrued liability are proper.

We further observe that, were the actual winning handle pull held to be the last event necessary to satisfy the "all events" test, the effect of such a holding would be to convert plaintiff, at least in this

instance, from an *accrual* basis taxpayer to a *cash* basis taxpayer. In the absence of the gaming commission's regulation, this might be a necessary step in order to ensure that plaintiff's method of accounting accurately reflected its financial status, inasmuch as plaintiff's liability for jackpots could not be known until a jackpot had been won. Because the regulation makes the jackpot amounts enforceable liabilities, however, plaintiff should be allowed to use a method of accounting that clearly reflects the existence of those liabilities for the period during which the liabilities were incurred. The court is satisfied that plaintiff's deduction of *net* accrued liabilities accomplishes this goal.

Were this the whole import of the *Nightingale* decision, this court, having respectfully declined to follow that decision, would have no need to continue. The *Nightingale* court, however, listed three other factors in support of its decision which we, again respectfully, reject. First, the *Nightingale* court stated that "[i]f the [casino] . . . were to close its doors and go out of business, . . . it would not owe the jackpots to anybody. This tends to show that there is no present liability." 684 F.2d at 615. This is a misstatement of the consequences. If the casino were to be relieved of the responsibility of paying off the slot machine jackpots which have already been deducted, the amounts displayed on the meters would constitute income. *See* IRC § 61(a); *Alice Phelan Sullivan Corporation v. United States*, 180 Ct. Cl. 659 (1967) (return or recovery of property that was once subject to a deduction must be treated as income in the year of its recovery). *See also Putoma Corp. v. Commissioner*, 601 F.2d 734, 741 (5th Cir. 1979).

The *Nightingale* court also appeared to be concerned that a Pandora's box would be opened if the deductions sought in that case were allowed. The concern was that accrual basis casinos would be able to avoid paying taxes simply by placing additional progressive slot machines set with very high initial jackpot amounts on their casino floors on the very last day of the fiscal year. This concern is obviated by the provisions of § 446(b) of the Code: "[I]f the method used [to compute taxable income] does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income." The Court of Claims has upheld, in no uncertain terms, the Commissioner's powers under this section:

> [Defendant] is no doubt correct in its position that the Commissioner has broad discretion to modify a taxpayer's accounting method to insure a clear reflection of income. *See Commissioner v. Hansen*, 360 U.S. 446, 467 (1959); *Lucas v. American Code Co.*, 280 U.S. 445, 449 (1930). Even where the taxpayer's accounting method complies with generally accepted principles, the Commissioner may reject it if he determines that it does not clearly reflect the taxpayer's income. *American Automobile Assoc. v. United States*, 367 U.S. 687, 692, 695 (1961). And in challenging the Commissioner's determination, the taxpayer has a heavy burden of proof to show a clear abuse of discretion. *Fort Howard Paper Co. v. Commissioner*, 49 T.C. 275, 284 (1967). [*Clement, et al. v. United States*, 217 Ct. Cl. 495, 509-510 (1978) (*per curiam*), *cert. denied*, 440 U.S. 907 (1979).]

The court also held that the Commissioner may modify not only the taxpayer's method, but also any particular item therein that distorts income: "It is settled that the Commissioner has discretionary authority to disallow a particular deduction on the ground that the timing of the payment distorts income." *Id.* at 510, *citing Burck v. Commissioner*, 533 F.2d 768, 773 (2d Cir. 1976) and *Sandor v. Commissioner*, 62 T.C. 469, 476-477 (1974), *aff'd*, 536 F.2d 874 (9th Cir. 1976). As evidenced by the decision in *Clement*, *supra*, this court will not hesitate to uphold the Commissioner's efforts to eradicate fraudulent practices, but, where no such practice has been alleged or proven and where the court has found that the timing of the deduction does not distort income, the court will not act on mere speculation.

One last issue that the *Nightingale* court addressed was its concern that the casino was deducting an expense that was not being matched in the current taxable year with the income of a winning customer. "To allow a deduction for an accrued expense would be to allow a deduction where there will be no corresponding income for perhaps four years or longer. Until then (the actual winning of the jackpot) there can be no accrual [sic] of income. . . ."[7] 684 F.2d at 615. The court's use of the word "accrual" is unclear here—moreover, it is *not* required that there be any matching of income and expense between two different taxpayers. The Court of Claims has declared that in a transaction between an accrual basis taxpayer and a cash basis taxpayer, the former is

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[7] The problem that the *Nightingale* court does not address is that accrued income is *always* subject to tax.

obligated to recognize expenses when the "all events" test is met, while the latter must only report income actually or constructively received. *Campbell v. United States*, 228 Ct. Cl. 661, 675 (1981). It is therefore irrelevant that there is no matching of income and expense between Harolds Club and its customers.

Defendant additionally avers that the tax court opinion in *World Airways, Inc. v. Commissioner*, 62 T.C. 786 (1974), *aff'd*, 564 F.2d 886 (9th Cir. 1977), supports its position that the first prong of the "all events" test has not been met by plaintiff. We disagree. The facts in *World Airways* showed that the plaintiff deducted estimated costs for future overhauls of its aircraft engines and airframes. Plaintiff argued that it was under contractual obligations to pay these costs and, thus, the liability was "fixed." The deduction was denied by the tax court because the expense was a contingent liability. The tax court held that the contracts merely obligated the *performance* of the overhauls at a future date and the plaintiff was under no obligation to pay until an overhaul was actually performed. 62 T.C. at 802. In the instant case, it is payment, not performance, that is obligated.

The liability was not found to be "fixed" in *World Airways* because the contracts could have been modified *at any time* by the parties; the contracts in that case "did *not* fix the fact of [plaintiff's] liability for the amounts accrued." *Id.* (Emphasis supplied.) If the deductions taken in *World Airways* were allowed, a deduction would have been permitted for an expenditure that might have never occurred. In the present case, the liability is *unconditionally fixed* by § 463.310 of the Nevada Revised Statutes which gives

full force and effect to Nevada Gaming Regulation § 5.110. *See* text, *supra*. In this action, the "guaranteed" jackpot liability becomes fixed for the taxable year on midnight of the last day of the fiscal year. Because "the accrual of a deduction item is permitted only in the taxable year when the obligation to pay it is unconditionally fixed," *id.*, this court is compelled to allow the deductions taken by Harolds Club.

The "all events" test, because it is to be applied to the particular facts presented in each different circumstance, must be applied on an *ad hoc* basis. The test is designed to aid taxpayers and the courts in determining when an accrued expense may be deducted, and to prevent various forms of tax evasion by preventing the deduction of contingent liabilities. It is clear that the IRS will not allow taxpayers to alter their tax liabilities *sua sponte* by deducting contingent liabilities. In the present case, however, only the Nevada State Legislature can alter the "guaranteed" jackpot liabilities of the casinos in that state. Under this circumstance, the claimed deduction satisfies the requirements of the "all events" test. The deduction is therefore a valid one under an accrual method of accounting, and should be allowed.

CONCLUSION

Based upon the foregoing discussion, this court concludes that the deductions taken by Harolds Club were timely. Therefore, defendant's motion for summary judgment is DISMISSED [*sic*], and plaintiff's motion for summary judgment is GRANTED.

The parties are hereby directed to submit to the court a joint stipulation as to the amount of the tax refund no later than July 30, 1984. Upon receipt of

such stipulation, the Clerk of the Court shall enter judgment for plaintiff accordingly.

IT IS SO ORDERED.

/s/ Robert M. M. Seto
ROBERT M. M. SETO
Judge

APPENDIX D

IN THE UNITED STATES CLAIMS COURT

No. 594-82T

HUGHES PROPERTIES, INC.

v.

THE UNITED STATES

[Filed: Aug. 1, 1984]

JUDGMENT

Pursuant to the order of June 29, 1984, and the stipulation filed by the parties on July 30, 1984,

IT IS ORDERED AND ADJUDGED this date, pursuant to Rule 58, that plaintiff recover of and from the United States the amounts as listed below, plus statutory interest:

Taxable Year Ending	Tax Refund Due
June 30, 1973	$172,909.70
June 30, 1974	97,802.61
June 30, 1975	139,008.11
June 30, 1977	23,721.46

Frank T. Peartree
Clerk of Court

APPENDIX E

Internal Revenue Code of 1954 (26 U.S.C.), as amended and as in effect for the years at issue:

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *

* * * * *

SEC. 446. GENERAL RULE FOR METHOD OF ACCOUNTING.

(a) *General Rule.*—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

* * * * *

(c) *Permissible Methods.*—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary.

* * * * *

SEC. 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

(a) *General Rule.*—The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.461-1 *General rule for taxable year of deduction.*

(a) *General rule.*—

* * * * *

(2) *Taxpayer using an accrual method.*—Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. However, any expenditure which results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year may not be deductible, or may be deductible only in part, for the taxable year in which incurred. While no accrual shall be made in any case in which all of the events have not occurred which fix the liability, the fact that the exact amount of the liability which has been incurred cannot be determined will not prevent the accrual within the taxable year of such part thereof as can

be computed with reasonable accuracy. For example, A renders services to B during the taxable year for which A claims $10,000. B admits the liability to A for $5,000 but contests the remainder. B may accrue only $5,000 as an expense for the taxable year in which the services were rendered. In the case of certain contested liabilities in respect of which a taxpayer transfers money or other property to provide for the satisfaction of the contested liability, see § 1.461-2. Where a deduction is properly accrued on the basis of a computation made with reasonable accuracy and the exact amount is subsequently determined in a later taxable year, the difference, if any, between such amounts shall be taken into account for the later taxable year in which such determination is made.

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